

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Curt Hébert, Jr., Chairman;
William L. Massey, and Linda Breathitt.

California Independent System
Operator Corporation

Docket Nos. ER01-1579-000
and ER01-1579-001

ORDER ACCEPTING IN PART AND REJECTING
IN PART ISO TARIFF AMENDMENT

(Issued May 16, 2001)

In this order, we accept in part and reject in part Tariff provisions filed by the California Independent System Operator Corporation (ISO), to become effective as discussed herein.

I. Background

A. Prior Proceedings

In the Commission's Order Directing Remedies for California Wholesale Electric Markets, issued on December 15, 2000, the Commission adopted specific remedies to address dysfunctions in California's wholesale bulk power markets and to ensure just and reasonable wholesale power rates by public utility sellers in California.¹ In the December 15 Order, among other things, the Commission established an underscheduling penalty as part of its comprehensive price mitigation plan. The Commission determined that the underscheduling problem jeopardized reliable system operations by forcing the ISO to satisfy far more load in real time than the market was intended to supply (*i.e.*, approximately five percent). Therefore, the December 15 Order required all market participants to preschedule their load and imposed penalties when real-time load exceeds more than five percent of an entity's scheduled load.

On February 2, 2001, in Docket No. EL01-34-000, Southern California Edison Company (SoCal Edison) and Pacific Gas and Electric Company (PG&E) filed a request for immediate suspension of the underscheduling penalty adopted by the Commission in the December 15 Order. In their filing, SoCal Edison and PG&E recognized that the purpose of the penalty was to alleviate the

¹San Diego Gas & Electric Company, *et al.*, 93 FERC ¶ 61,294 (2000), reh'g pending (December 15 Order).

reliance on the ISO's energy imbalance market to meet load. They noted, however, that certain events had made it impossible for them to expand their forward purchases: (1) the California Power Exchange has suspended operating certain markets; and (2) SoCal Edison and PG&E have experienced credit and supply problems. SoCal Edison and PG&E maintained that given these circumstances, the underscheduling penalty cannot provide an incentive to their procurement strategy and instead amounts to an additional tax on their already expensive energy purchases.

In an order issued on April 6, 2001, in response to SoCal Edison's and PG&E's request, the Commission expressed concern that the appropriate amount of long-term contracts had not been executed on behalf of SoCal Edison and PG&E and that long-term supply may not be available because it has been contracted to serve other load.² In light of these concerns, the April 6 Order deferred considering whether to grant the request to suspend the underscheduling penalty provision and further directed the ISO to file a comprehensive report on the current and projected market situation. The ISO's report would quantify the amount of load that SoCal Edison and PG&E will serve through forward purchases and the projected amount of load that will continue to be supplied through the ISO's imbalance market for each calendar month from April 2001 through September 2001. On April 23, 2001, in Docket No. EL01-34-001, the ISO filed a report.

B. ISO Tariff Amendment No. 38

On March 20, 2001, as amended on March 29, 2001,³ the ISO filed proposed Amendment No. 38 to the ISO Tariff. Amendment No. 38 would amend the ISO Tariff in two respects. First, it would suspend the penalty for underscheduling load, *i.e.*, the requirement that market participants have at least 95 percent of their load scheduled prior to real-time. In support, the ISO states that underscheduling continues to be a problem in the California market and that most of the shortfall in the amount of forward scheduled load is attributable to Pacific Gas and Electric Company (PG&E) and Southern California Edison (SoCal Edison) (collectively, IOUs). The ISO notes that, in view of the IOUs' current financial difficulties, the IOUs cannot make their own bilateral purchases or access forward markets. Thus, it asserts, the IOUs are incapable of scheduling 95 percent of their load and would be unable to pay for penalties imposed in addition to the cost of energy. Thus, the ISO proposes to temporarily suspend the load underscheduling penalty, effective from January 1, 2001 through May 31, 2001. The ISO requests waiver of the 60-day notice requirement to permit the January 1, 2001 effective date.

²Southern California Edison Co. and Pacific Gas and Electric Co., 95 FERC ¶ 61,025 (2001) (April 6 Order).

³On March 29, 2001, in Docket No. ER01-1579-001, the ISO submitted an erratum filing.

Amendment No. 38 would also allow market participants with resources that have been selected to provide Spinning and Non-Spinning Reserves (collectively, Operating Reserves) the ability to indicate that their resources should not be dispatched to provide Imbalance Energy unless there is a contingency or an imminent or actual system emergency.⁴ The ISO's proposal will effectively split the BEEP stack. The ISO explains that Operating Reserves are intended to be used for contingencies such as the loss of a generating unit or of a transmission path, or system emergencies such as the imminent loss of firm load, voltage collapse or transmission path overload. The ISO believes that this split BEEP stack proposal will assist it in preserving contingency Operating Reserves and increase the supply of those reserves by enabling market participants to indicate that these reserves should be dispatched to provide Imbalance Energy only if there is a contingency or an imminent or actual system emergency. Due to software changes and the operational mechanisms required to implement the split BEEP stack proposal, the ISO requests an effective date of the later of May 18, 2001, or at least ten days after the ISO posts notice on its home page that the modified software is ready for use to accommodate this change.

C. Notice of Filing and Pleadings

Notice of the ISO's filing was published in the Federal Register,⁵ with motions to intervene and protests due on or before April 10, 2001. Timely motions to intervene raising no substantive issues were filed by: Williams Energy Marketing & Trading Company; Northern California Power Agency; Transmission Agency of Northern California; and Turlock Irrigation District.

The Public Utilities Commission of the State of California (California Commission) filed a notice of intervention. Timely motions to intervene were filed by: California Department of Water Resources (DWR); California Electricity Oversight Board (Oversight Board); Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC (Duke); Modesto Irrigation District (Modesto); City of Vernon, California (Vernon); Cities of Redding and Santa Clara, California and M-S-R Public Power Agency (Cities/M-S-R); Enron Power Marketing, Inc. and Coral Power, L.L.C. (Enron); Dynegy Power Marketing, Inc., El Segundo Power LLC, Long Beach Generation LLC, Cabrillo Power I LLC and Cabrillo Power II LLC (Dynegy); Pacific Gas and Electric Company (PG&E); Southern California Edison Company (SoCal Edison); and Mirant Americas Energy Marketing, LP, Mirant California,

⁴Ancillary Service bids consist of two price components, capacity and energy. The energy component is used in the real-time Imbalance Energy or "BEEP" stack to determine the order in which capacity from Ancillary Services is converted to energy. The acronym BEEP comes from the name of the software (i.e., Balancing Energy and Ex-post Pricing software) used to dispatch energy from Ancillary Service capacity and supplemental energy bids to meet real-time demands.

⁵66 Fed. Reg. 17,416 (2001).

LLC, Mirant Potrero, LLC and Mirant Delta, LLC (Mirant). On April 25, 2001, the ISO filed an answer.

Comments and protests were filed by the California Commission, PG&E, SoCal Edison, the Oversight Board, Duke, Modesto, Vernon, Cities/M-S-R, Enron, Dynegy, DWR and Mirant. Enron also moves for summary rejection of the filing. Modesto, Vernon, Cities/M-S-R and Mirant also request consolidation of Docket No. ER01-1579-000 with Docket No. EL01-34-000.

II. Discussion

A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁶ the notice of intervention and the timely, unopposed motions to intervene serve to make those who filed them parties to this proceeding.

Under Rule 213 of the Commission's Rules of Practice and Procedure,⁷ answers to protests are prohibited unless otherwise permitted by the decisional authority. We are not persuaded to allow the ISO's proposed answer and accordingly will reject the answer.

B. Suspension of Underscheduling Penalty Proposal

1. Comments

Enron moves for summary rejection of the ISO's filing. Enron disputes the ISO's Governing Board's authority to approve and sponsor any filings with the Commission, arguing that the Governing Board was seated in violation of the Federal Power Act (FPA), the Commission's December 15 Order, other orders addressing ISO governance and the ISO's bylaws on file with the Commission. Enron argues that Commission precedent supports rejecting filings by public utilities that are made at the specific direction of state authorities. According to Enron, the ISO is not independent of market participants, because the Governing Board is selected by, subject to the direction of, and accountable to the Governor of California.

⁶18 C.F.R. § 385.214 (2000).

⁷18 C.F.R. § 385.213 (2000).

Several parties request that, in view of the April 6 Order, the Commission nominally suspend Amendment No. 38, defer action on the filing pending the ISO's submission of the report directed by the Commission in the April 6 Order, and consolidate Docket Nos. ER01-1579-000 and ER01-1579-001 with Docket No. EL01-34-000.⁸

With respect to the proposed suspension of the underscheduling penalty, the Oversight Board opposes re-instituting the penalty on June 1, 2001. It argues that the provision does not serve the intended purpose of encouraging forward contracting, because the IOUs' creditworthiness problems do not allow them to engage in forward contracting. It further argues that the penalty is unnecessary to encourage forward contracting, because DWR is required by state law to make purchases for the IOUs' net short load.

Modesto and Vernon assert that suspension of the underscheduling penalty will worsen reliability problems. Vernon also argues that the ISO should focus on its mission of ensuring reliable service rather than being a provider of last resort for the IOUs.

Regarding the applicability of the underscheduling penalty to market participants, Modesto argues that suspension of the underscheduling penalty is discriminatory against those entities like Modesto that do balance loads and resources. Dynegy asserts that the ISO is still imposing severe penalties on suppliers, who often cannot avoid incurring the dispatch penalty. Dynegy argues that it is unfair to propose to suspend the penalty for loads without granting similar relief to suppliers. On the other hand, the California Commission comments that, if the underscheduling penalty is reimposed, then it should apply to both supply and demand. Further, Dynegy contends that DWR should be held accountable for underscheduling. Dynegy alleges that DWR has persistently underscheduled its load, with a continuing serious impact on the real-time markets, without facing any underscheduling penalties. Dynegy urges that DWR be treated like any other scheduling coordinator with regard to the underscheduling penalty.

The Oversight Board questions whether DWR will be able to cover the IOUs' needs as quickly as the ISO projects, and it argues that the underscheduling penalty should be suspended indefinitely without prejudice to reinstatement upon proof that the IOUs' credit ratings permit unrestricted access to forward markets. Duke does not oppose the suspension of the underscheduling penalty, but it requests that the Commission emphasize that it is only a temporary measure. The California Commission comments that the need for the underscheduling penalty should be revisited when the ISO implements day-ahead and hour-ahead energy markets.

2. Commission Determination

⁸Comments of Modesto, Vernon, Cities/M-S-R and Mirant.

Due to our current consideration of waiver of the underscheduling penalty in Docket No. EL01-34-000 and the recently submitted information on underscheduling provided by the ISO in the same proceeding, we will reject the ISO's proposal to suspend the underscheduling penalty. We are currently reviewing the report that the ISO filed, in Docket No. EL01-34-001, pursuant to the April 6 Order. We will make a determination regarding whether to suspend the underscheduling penalty in a future order in that proceeding.

In light of our rejection of the proposed underscheduling suspension provision in Amendment No. 38, we will dismiss Enron's motion to reject as moot. We note, however, that by order issued on April 26, 2001,⁹ the Commission, among other things, stated that it would address compliance with the ISO governance provisions of the December 15 Order in a subsequent order. We further note that on April 26, 2001, in Docket No. ER01-1877-000, the ISO filed amended bylaws. The issue of compliance with ISO governance provisions may be raised in that proceeding.

Further, in view of our rejection of the proposal to suspend the underscheduling penalty, there is no basis for consolidation of Docket Nos. ER01-1579-000 and ER01-1579-001 with Docket No. EL01-34-000, and we will deny the motions to consolidate the dockets.

C. Split the BEEP Stack Proposal

1. Comments

The Oversight Board, PG&E, SoCal Edison, Mirant and Vernon support the ISO's proposal to split the BEEP stack. The California Commission conditionally supports the proposal. It states that if the supply of Operating Reserves does not increase, the ISO could end up with two, thin volatile markets and be worse off than it is now. Thus, the California Commission requests that approval of Amendment No. 38 expressly provide the ISO with flexibility to go back to the current system if additional supplies for Operating Reserves do not materialize. The California Commission also states that it understands that the ISO's proposal is likely to be superseded by the Market Stabilization Plan which the ISO intends to file in the near future.

Dynegy argues that the ISO's proposal complicates the markets without any benefit. It contends that it does not matter which stack a supplier bids into because the supplier only has a limited allotment of energy (*i.e.*, because of available water or emissions credits). Further, Dynegy asserts that the ISO already has the authority to skip supply in the BEEP stack. Dynegy argues that the ISO needs more justification for its proposal.

⁹San Diego Gas & Electric Co., *et al.*, 95 FERC ¶ 61,115 at 61,353 n.9 (2001).

DWR argues that a single price auction fails to distinguish merchant generation and other generation dedicated to a specific purpose, such as DWR's hydroelectric generation, or load which has a primary purpose other than serving the electric grid. It argues that the ISO's proposal could have unintended consequences, because it would permit any merchant generation to choose to be designated as being dispatched only in the event of an unplanned outage, a contingency or an imminent or actual system emergency. DWR urges the adoption of a more stringent "last resort" designation that would essentially place energy bids from Operating Reserves at the bottom of the merit order stack for dispatch purposes.

2. Commission Determination

We will accept the ISO's proposal to split the BEEP stack, to become effective as proposed by the ISO. The ISO notes that under the Western Systems Coordinating Council (WSCC) Minimum Operating Reliability Criteria (MORC), the ISO must maintain contingency Operating Reserves equal to 5 percent of the demand to be met by generation from hydroelectric resources plus 7 percent of the demand to be met by generation from other resources. The ISO contends that with the energy shortages of the past few months, there have been frequent deficiencies in Operating Reserves. According to the ISO, it incurred over \$1 million in WSCC penalties in the year 2000 due to Operating Reserve shortfalls. In accepting the ISO's proposal, the amount of Operating Reserves should increase, particularly hydroelectric resources that are water limited and thermal generating plants that face emission constraints. Under the ISO's proposal, these units will indicate that they only should be dispatched for Imbalance Energy during system contingencies. Therefore, more units should bid into the Operating Reserve markets when the risk of system contingencies are low.

In addition, the ISO's proposal to split the BEEP stack will eliminate the probability of aberrational bidding behavior when the risk of system contingencies are high. In the past, per the ISO's suggestion, units submitting Operational Reserve bids that were energy constrained would submit high energy bids to discourage the ISO from dispatching these units for Imbalance Energy. However, during system contingencies, these units would be dispatched for Imbalance Energy. DWR notes this practice may have inadvertently set the market clearing price during certain hours in the summer of 2000.¹⁰ The ISO's proposal will remove this type of bidding behavior because sellers will no longer need to submit

¹⁰DWR Protest at 2.

high energy bids to avoid being dispatched. Moreover, the ISO's proposal should lower the incidence of the ISO incurring WSCC penalties during the remainder of 2001, thereby lowering California consumers' electric bills.

We reject Dynegy's argument that splitting the BEEP stack will needlessly complicate the market. While the ISO will need to add software to implement the instant proposal, Dynegy has not explained how a simple notification indicating whether the seller's capacity is available to supply Imbalance Energy submitted concurrently with a seller's bid for Operating Reserves will complicate the market. According to the ISO, splitting the BEEP stack could bring as much as 1,000 to 2,800 MW of additional Operating Reserve bids into the market.¹¹ The magnitude of the benefits of the ISO's proposal far outweigh any undefined complication of the market.

We also reject DWR's request for a "last resort" bid designation. DWR's proposal would add another layer of "last resort" bids that would only apply to loads and dedicated purpose generation. Under DWR's proposal, merchant generation would be dispatched prior to load and dedicated purpose generation. DWR's proposal would require additional software changes to implement. In addition, it is unclear if DWR's proposal would add any additional capacity to the Operating Reserve markets beyond the amount already identified by the ISO.

The Commission orders:

(A) Enron's motion to reject Amendment No. 38 to the ISO Tariff is hereby dismissed as moot, as discussed in the body of this order.

(B) The ISO's proposed Amendment No. 38 to the ISO Tariff, in Docket Nos. ER01-1579-000 and ER01-1579-001, is hereby accepted for filing in part and rejected in part, to become effective as discussed in the body of this order.

(C) The motions for consolidation are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

David P. Boergers,

¹¹ISO Application at Attachment F, February 27, 2001, memo.

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Secretary.